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Top 10 Economic Predictions for 2021

In 2020, the global economy endured its deepest recession in 74 years, as the COVID-19 virus pandemic upended lives and livelihoods. The recession was unprecedented in its geographic scope, the central role of services, and the scale of policy responses. While the COVID-19 virus will stay with us throughout 2021, the rapid development and deployment of vaccines will enable a transition to a new post-pandemic economy. Thus, 2021 brings with it a mixture of caution and hope. Navigate the momentous new year with the top-10 economic predictions from IHS Markit.

1 While the COVID-19 virus will stay with us, effective treatments and vaccines will be widely available to large segments of populations by mid-2021, facilitating a transition to the post-pandemic economy

The world's most ambitious global vaccination campaign will be undertaken in the first half of 2021 with around half a dozen vaccines. They will play a critical role in containing the pandemic in advanced and emerging markets. Public health, track and trace, and nonpharmaceutical interventions will still be needed during the rollout of vaccines. The virus itself is unlikely to go away in 2021, and there is a risk of periodic, small outbreaks if the public resists vaccination, governments cannot vaccinate entire populations, or the virus mutates to a form that requires vaccines to be adapted. However, wider availability of antibody and antiviral treatments, as well as improved track-and-trace systems will ensure that blunt 2020-style lockdowns will no longer be needed.

2 The global economy will enter 2021 at a subdued growth rate and accelerate to a brisk pace in the second half.

Headwinds to robust near-term growth include COVID-19-related lockdowns in early 2021, lingering consumer and business caution, diminishing fiscal support, and the strains of rising public and private debt. Yet, the reopening of economies and the availability of vaccines will gradually unleash a new wave of spending on travel and services. With more spending opportunities, household saving rates will retreat from the unusually high levels of 2020. After a 4.0% decline in 2020, world real GDP should increase about 4.5% in 2021. Before year-end, global output will reach a new peak. Recovery timelines vary widely across regions: mainland China fully recovered in the second quarter of 2020, but recoveries in Japan and several major European economies will take until 2023 or 2024. While unemployment rates will fall in most regions in 2021 as output recovers, Western Europe will see a rise in joblessness as public funding of furlough programs diminishes.

3 In 2021, the focus of investors and policymakers will shift from COVID-19 to the environment.

An important trend in private and public debt markets is the rise in environmental, social, and corporate governance (ESG) issuance, often at slightly lower yields than conventional equivalents. The European Union will become a leading issuer in 2021 to fund its EUR750-billion Recovery and Resilience Facility (RRF). The United Kingdom plans to issue its first "green" bond in 2021. Another trend is greater use of sustainability-linked issuance, linking coupons to the achievement of ESG goals. Emphasis on ESG will exacerbate the financing difficulties of some energy and commodity producers, as new

investments are scrutinized for their ESG contributions. Meanwhile, policy support of renewable energy from key governments (European Union, mainland China, Japan, South Korea, and California) and declining costs for wind, solar, and battery power will accelerate the energy transition and restrain hydrocarbon demand and prices.

4 Monetary policies will remain accommodative, and more central banks will lean toward the US Federal Reserve's flexible average inflation targeting (FAIT) policy.

The Fed's new approach reinforces that its 2% inflation objective is an average, not a ceiling. The European Central Bank (ECB) will likely follow the Fed's lead on FAIT when it concludes its strategy review in mid-2021. Policy rates in the United States, eurozone, United Kingdom, and Japan will remain near or below zero well beyond 2021. In emerging markets, where inflation is a more immediate concern, monetary easing is ending, but policy rate increases will be rare in 2021.

Term yields will gradually increase through 2021 as economic recoveries gain traction and investors anticipate an eventual tightening of monetary policies. With the end of the pandemic in sight, investors' appetite for risk will increase. The net

effect of a declining equity risk premium and rising yields on long-dated government bonds will be a modest advance in equity prices in 2021.

5 The global financial sector should avoid major crises in 2021—at least in advanced economies—but banking risks will rise.

Regulatory reforms that followed the global financial crisis have yielded substantially larger capital buffers and improved liquidity conditions across global banks. The lack of widespread credit booms ahead of the pandemic suggests banks are better prepared to meet the challenge of rising bankruptcies and high unemployment rates. In major advanced economies, expansionary monetary policies will keep term debt costs sharply lower, offering banks scope to arrange favorably priced, longer-term funding for capital and liquidity while easing debt-servicing burdens for bank borrowers even as debt levels surge. More fiscally constrained emerging markets will rely heavily on forbearance measures to contain bank losses as the economic rebound takes hold. However, rising public and private debt burdens could lead to significant strains for banks heavily invested in local sovereign debt. As support measures start to diminish in 2021, credit risks in countries such as Angola, India, Kenya, and Turkey are likely to rise swiftly.

6 Finished goods prices will accelerate in 2021.

Commodity prices rose sharply in the second half of 2020 as the global economy rebounded; these cost increases will be pushed downstream in supply chains for the next six to nine months, pressuring margins and leading to higher prices for finished goods in 2021. After vaccines become more widely available in the second half of 2021, consumption patterns will begin to shift back toward services suppressed by the pandemic. Supply-chain disruptions should also slowly be resolved. Goods industries could then see conditions soften even as aggregate demand strengthens. Iron ore is a notable exception: lower production guidance for 2021 potentially exposes the market to a period of extended tightness. In the oil market, OPEC+ producers have agreed to increase supply in modest monthly increments that can be paused or reversed, depending on the market’s pulse. As transportation demand picks up, crude oil prices will rise above USD50/barrel in the closing months of 2021. Global consumer price inflation is projected to edge upward to 2.2% in 2021, restrained by slack labor markets and well-anchored inflation expectations in the advanced countries.

7 The US economy will start 2021 slowly and accelerate in the second half.

The US economy has partially recovered from its worst downturn since the Great Depression. However, a new wave of COVID-19 virus infections, the possible reimposition of lockdowns to contain them, and waning stimulus from pandemic relief measures enacted in 2020 threaten to undermine growth through early 2021. Unexpectedly rapid progress on vaccines should promote an acceleration in GDP during the second half of the year. If no further fiscal stimulus arrives and aggressive lockdowns are implemented to contain surging infections, real GDP growth could be just 3% in 2021, with weakness concentrated early in the year. If Congress implements another significant stimulus bill soon, and a highly successful inoculation program is well under way by summer, real GDP growth could exceed 5%. With unemployment still elevated, inflation and interest rates will remain low in 2021.

President-elect Biden is expected to use executive orders to reverse certain of President Trump’s policies on regulation, tariffs, and immigration. The near-term effect of these initiatives will be minor compared with the effects governed by fiscal policy and the course of the pandemic. As Biden takes more predictable, multilateral approaches to trade policy, climate change, and world health, the risk premium attached to policy uncertainty will decrease. A Republican-led Senate would likely stymie Biden’s legislative agenda. A Democratic-led Senate could, after negotiations and debate, pass certain elements of the agenda, but their economic impact would be felt largely after 2021.

8 Europe’s 2021 annual growth rates will fall short of market consensus expectations.

After a very weak final quarter of 2020, the COVID-19 virus’ prevalence and related containment measures will continue to hinder the recovery early in 2021. Lagged increases in business failures and unemployment will also restrain growth as policy support diminishes, although we expect a pronounced, vaccine-driven pickup in eurozone growth rates from midyear. After an estimated 7.5% contraction in 2020, eurozone real GDP is projected to rise about 3.5% in 2021, with the return to pre-pandemic levels not expected until late 2022. Germany, with its comparatively high manufacturing and export sensitivities, will continue to outperform. Peripheral economies with higher exposure to areas most affected by COVID-19 (including tourism and related services) and lesser policy space will underperform. Technical factors (German value-added tax and energy base effects) will push up headline inflation in early 2021, but underlying rates will remain low. Given this backdrop and challenging public-sector deficit and debt dynamics, the ECB will maintain a highly accommodative monetary policy stance. Any signals of constraint on monetary policy support would likely lead to a highly unstable mix of financial stresses, including upward pressure on sovereign bond yields, spreads, and the exchange rate.

9 Mainland China's economy will accelerate to the strongest growth rate in recent years, but the rebound will wane

The expected launch of effective COVID-19 vaccines, pent-up demand, and a low base effect will help the Chinese economy to grow 7.5% in 2021, its highest rate since 2013. After the cyclical rebound, the economy will return to the deceleration path that began in 2012, as productivity growth slowed in response to stalled economic reforms. Given the continued slow progress in reforms, the underlying drag on growth remains. Moreover, mainland China's corporate debt shot up again in early 2020. In response, the government will thus tighten liquidity as the economic expansion firms, which will restrain investment. Other headwinds facing mainland China's economy include a declining working-age population and structural economic tensions with the United States, which will lead to continued sourcing diversification away from mainland China.

10 The US dollar should weaken in 2021 in a lagged response to the Fed's sharp pivot to monetary accommodation in early 2020, an increase in investor risk tolerance, and a widening trade deficit.

ECB policy accommodation should lean against substantial further euro appreciation, although expected US dollar weakness and continued high current-account surpluses represent upside euro risk. The European Union's RRF is an important step forward in the mutualization of fiscal obligations, reducing eurozone breakup risks. The Japanese yen will benefit from strengthening exports and relatively low inflation. While policy convergence will limit exchange rate movements in the major economies, more currency volatility is expected in emerging markets. The currencies of countries with high inflation, such as Argentina, Turkey, and Nigeria, will further depreciate; the currencies of countries with mild inflation and strengthening exports, such as Brazil and mainland China, will appreciate. The renminbi will be supported by mainland China's accelerating economy and comparatively conservative monetary policy.